

**Business Executives
for National Security**

FINDING EFFICIENCIES IN THE BUSINESS OF DEFENSE:

Reducing Fuel Cost for the Defense Logistics Agency



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Prepared by the

BENS TASK FORCE ON DLA FUEL

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WHO WE ARE

Business Executives for National Security is a unique nonpartisan, nonprofit organization of senior executives who volunteer time, expertise, and resources to assist defense and homeland security leaders on a variety of national security challenges.

OUR MISSION

Apply best business practice solutions to our nation's most challenging problems in national security, particularly in defense and homeland security.

ACKNOWLEDGMENTS

BENS gratefully acknowledges the expert contributions of our membership, their colleagues, and their staff. We would also like to acknowledge the tremendous assistance received from the senior leadership of the Defense Logistics Agency and the staff of the Defense Logistics Agency-Energy.

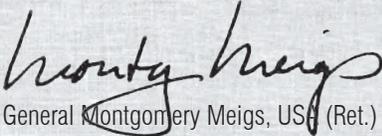
PREFACE

This report, written upon request of Defense Logistics Agency (DLA) Director, Vice Admiral (VADM) Mark Harnitchek, identifies measures that will reduce DLA's fuel operational cost as well as improve the Agency's fuel distribution network and budgetary practices. DLA oversees a \$46 billion global logistics network with nearly half – \$20 billion – appropriated by its Energy arm and consumed by the burgeoning price of fuel. With a globe-spanning logistical footprint and a budget on par with the state of Colorado, DLA-Energy represents a prime target for efficiency savings.

Business Executives for National Security (BENS) is uniquely positioned to confront this issue and welcomes the opportunity to do so. The senior business leaders who comprise BENS understand the management of global enterprise, but moreover, have experience optimizing procurement and logistics strategies in downsized fiscal environments. Current United States defense strategy calls for hundreds of billions of dollars in defense cuts over the next decade, and it will be incumbent upon DLA and all other organizations within the Department of Defense to streamline operations and reduce costs. In fact, DLA has chosen to spearhead these efforts with an internal goal of reducing their annual budget ten percent (\$10 billion) over the next five years – an ambitious goal that this report intends to help DLA achieve.

BENS commends VADM Harnitchek and his senior staff for reaching out to us, and other thought leaders in industry, to help provide the ideas needed to achieve their goals. These austere times will require innovation – not only in technology, but also in process. We must learn to do more with less. For DLA, this will require delivering the same level of dependable support to the warfighter at a fraction of the current budget.

BENS welcomes a continued dialogue with DLA following the presentation of this report. Our organization will continue to offer our assistance as DLA moves to achieve their cost reduction and improvement goals.



General Montgomery Meigs, USA (Ret.)
President & CEO
Business Executives for National Security

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EXECUTIVE SUMMARY

In Fall 2012, Director of the Defense Logistics Agency (DLA), Vice Admiral (VADM) Mark Harnitchek, asked Business Executives for National Security (BENS) to analyze a series of prior recommendations aimed at improving DLA's fuel procurement operations. Furthermore, VADM Harnitchek requested that BENS highlight additional practices to improve DLA's fuel procurement and distribution system.

Each recommendation was considered by BENS members with experience in the fuel industry and enterprise management and assessed using the BENS members' industry knowledge and expertise. Each prior recommendation was weighed by its savings potential and means of implementation. Additional recommendations were formulated after thorough review of DLA's unique operational context.

ANALYSIS OF PRIOR RECOMMENDATIONS

Over the course of its study, BENS made two key findings. First, DLA is a proficient buyer of fuel whose overall procurement expenditures align closely with the private market. Second, significant cost reductions on a nine-figure scale or higher will only occur with a reduction in overall fuel demand.

When analyzing prior recommendations made by DLA's consultants, BENS found that DLA is already pursuing nearly all efficiency opportunities suggested. While BENS offers refinements for DLA's implementation process, BENS members do not anticipate more than marginal savings resulting from most of these initiatives.

The prior recommendation with highest value to DLA is the acceleration of transition to commercial grade fuels. Expanded use of commercial fuels will improve product fungibility, improve storage efficiency, and offer comparatively lower prices with an increased pool of providers. Once this process is complete, DLA could achieve savings between \$25 million and \$37.5 million. However, the burden for implementing this process rests with the individual Armed Services. DLA will not reap the full savings until the transition is complete, but savings will be appreciable once this occurs.

BENS RECOMMENDATIONS

In the process of conducting its study, BENS also produced a series of original recommendations that could further improve DLA's fuel procurement and distribution operations:

Provide Incentives that Drive Service Demand to DFSPs that are Lower Relative Cost to DLA

It is possible for DLA to drive end-user demand toward Defense Fuel Supply Points (DFSPs) that are relatively cheapest to staff and provision. This can be accomplished with a fractional rebate system that encourages Service planners to utilize specific DFSPs over the course of nonessential operations. This system is applicable within the existing Standard Price framework.

Although BENS does not believe that cost should be a major contributing factor in combat and contingency operations, there is ample opportunity for savings over the course of day-to-day fuel use. Implementing this system will place DLA's operations closer in line with the distribution networks of private enterprise without compromising its core mission focus.

Reform Standard Price Formulation to Create More Accurate Budgeting

Although DLA has limited institutional involvement with Standard Price formulation, BENS nonetheless urges increased intra-departmental pressure to give DLA added input into this process. The Agency is best positioned to inform a more accurate, stable Standard Price.

Recent Standard Price revisions caused by an increasingly volatile fuel market have defeated the entire purpose of the budgeting mechanism: keeping fuel prices steady for individual Armed Service planners. Steps must be taken to end these drastic, mid-year Standard Price revisions.

Enhance Supplier Relationship Management to Secure Lower Prices

The Task Force has identified five individual initiatives that DLA-Energy can undertake to improve its supplier relationship practices:

1. Shift contract pricing basis to New York Mercantile Exchange (NYMEX)
2. Consolidate contract solicitation packages
3. Reduce time to contract award
4. Improve carrier selection and coordination
5. Share refined demand projections with suppliers

Aligning with industry norms, when possible, will eliminate much of the added risk present in prices quoted to DLA. According to interviewed suppliers, it is "an accumulation of small inconveniences" that often leads DLA to receive sub-optimal pricing. Reforming these inconveniences will lead to a corresponding reduction in average price.

Take Advantage of Change Management Practices to Help Senior Leadership Meet Goals

DLA must continue to meet the same level of mission support despite facing a reduced fiscal environment. Many senior military and DoD officials have not experienced this type of challenge recently, as DoD has largely seen an influx of capital for the past decade, and as such could benefit from the insights of leaders who have met similar challenges in the past. Industries within the private sector routinely experience significant shifts in their operating budgets and industry leaders can offer their insights for DLA's purposes.

BENS proposes leveraging the executive mentoring capabilities already established through the BENS Mentor Program. If VADM Harnitchek finds value in this program, the BENS program would be expanded to provide DLA's senior officials with private sector leaders who can help guide them in meeting their budgetary and mission goals.

CONCLUSION

BENS was pleased to find that DLA is a proficient fuel buyer and is already pursuing many available opportunities to improve their fuel operations. Ultimately, however, all of these initiatives offer only marginal savings; true billion-dollar cost reduction will come with decreased volume of demand. It is incumbent upon DLA to promote the initiatives contained within this study while continuing to take steps to reduce the military's fuel footprint.

Introduction

In the fall of 2012, Business Executives for National Security (BENS) was asked to examine the Defense Logistics Agency's (DLA) fuel operations to provide insight on measures that would boost its efficiency and reduce annual expenditures. DLA, the primary buyer and supplier of fuel for the Department of Defense (DoD) and the military services, currently oversees a \$46 billion enterprise, including \$20 billion in fuel-related operations.¹ DLA has set a goal to reduce its overall annual budget by \$10 billion in five years.² Because purchasing and supplying fuel accounts for nearly half of DLA's annual budget, senior leadership within the Agency believe fuel operations could deliver a considerable portion of their desired savings – possibly up to \$5 billion.

Vice Admiral (VADM) Mark Harnitchek, Director of DLA, specifically asked BENS to analyze several efficiency proposals recommended by previous consultants and highlight measures that provide the highest relative value. BENS additionally offered to identify private sector practices that could be harnessed to help meet DLA's goals using its structural and operational requirements.

Several BENS members with varied experience in the fuel industry and enterprise management volunteered to take on this assignment. They included private sector leaders who oversee fuel refining operations and fuel supply networks as well as senior industry consultants in energy and executive development. This group is hereafter referred to as the “Task Force.”

Over four months, the Task Force reviewed current DLA practices and compared them with industry standards. The Task Force was briefed by DLA personnel to ensure they possessed a comprehensive understanding of DLA’s processes and were aware of current DLA reforms. They specifically worked with DLA-Energy, the sub-agency within DLA who directly oversee and execute fuel operations. The Task Force examined DLA procurement data and budgeting methods, evaluated the potential for annual savings by opportunities identified in prior efforts, and identified and evaluated additional savings opportunities from their own private sector experiences that could be incorporated into DLA’s operating procedures.

This report represents a compilation of the Task Force’s findings and recommendations. In general, the Task Force concluded that DLA-Energy is a proficient and effective fuel purchaser and supplier and that opportunity for significant savings from fuel operations beyond the efficiency measures already being pursued are limited on the supply-side. However, there are demand-side measures – some beyond the scope of DLA – that would improve Department-wide fuel operations. DLA should incentivize or encourage implementing these measures as they would improve Agency operations and could reduce annual costs.

OVERVIEW OF DLA-ENERGY

DLA is a logistical support agency whose primary role is to provide DoD and military forces supplies and services. DLA is responsible for buying and supplying 100 percent of the military’s consumable items which include, among other things, clothing, food, and medicine. DLA also buys and supplies fuel. And among their eight supply chains, fuel represents the largest portion of their current budget – roughly \$20 billion.³

DLA, through DLA-Energy, manages 603 fuel supply points worldwide and over \$18 billion in fuel contracts that supply approximately 13 million gallons of fuel per day. DLA-Energy is funded through the Defense Working Capital Fund (DWCF) which is a revolving revenue stream that, unlike typical governmental funds, does not expire at the end of a fiscal year. DLA-Energy receives an “inflow” of capital by selling fuel to DoD

and the Armed Services at a government-set Standard Price. The cost of doing business – procurement, storage, transportation, etc. – represents an “outflow” of capital. Notionally, sales are intended to equitably offset cost and allow the DWCF to break even. While this system remained revenue-neutral for 20 years, it has become victim to an increasingly volatile fuel market and has required supplemental funding via internal DoD budgeting or Congressional appropriation.

Fuel procurement, primarily jet fuel, represents the largest outflow of capital: 92 percent of DLA-Energy’s budget is dedicated to procurement.⁴ Unlike private and civilian consumers who use the commercial jet fuel variant, Jet A, DLA requires primarily military specification (MILSPEC) fuels that provide greater storage stability, lower pour points, lower freeze points, and higher flash points. These mostly comprise the aviation jet fuel JP8, naval aviation jet fuel JP5, and naval ship fuel F76. In total, DLA represents the fourth-largest buyer of jet fuel in the U.S. However, because those purchases are of primarily MILSPEC grades, they align more closely with the narrower market for middle-distillate fuels than the broader market for commercial jet fuels.⁵

Fuel is typically purchased through competitive one-year contracts and awarded to suppliers who offer the lowest cost at point of delivery. The contract assessment and awards process constitutes a critical Agency focus with roughly 70 bulk petroleum contracts awarded each year, approximately 45 of which are specifically MILSPEC fuels. The average value of a contract is \$100 million, allowing DLA to take advantage of price breaks from large purchases. The contract award process takes approximately nine months from requirements determination to final product delivery, with each contract subject to several levels of scrutiny and adherence to all applicable Federal Acquisition Regulation, DoD-specific regulation, Agency-wide DLA directives, and all applicable laws that address government procurements.

The purchasing process is overseen by four regional, self-contained purchasing programs, handled by an overseas and a domestic contracting team. The purchase program regions are:

- Inland/East/Gulf Coast
- Atlantic/Europe/Mediterranean
- Rocky Mountain/West Coast
- WestPac

In more than 90 percent of cases, these regional offices are also responsible for supply planning execution, i.e., coordinating ground transportation (pipelines, barges, trucks, rail, etc.) for purchased fuels.

KEY FINDINGS

As an Agency, DLA is an effective fuel buyer and their purchases are comparable to the rates average commercial airlines have paid in the same year. In fact, in certain years, DLA outperforms industry. As shown in Figure 1, the Task Force found that DLA outperformed industry in four of the eleven years charted for both a specialty fuel like JP8 and for commercial jet – which includes purchases of commercially used Jet A. For commercial jet fuels, DLA frequently outperforms the commercial sector. Over the period considered, DLA averaged \$1.03 less per barrel.

There have been instances, however, where DLA fuel costs spiked well above the commercial sector, such as 2008 and 2011. However, these occasions are ultimately infrequent and are likely attributable to specific mission demands of the Services.

There is considerable discussion by policy professionals about realigning DLA's procurement practices to mirror those of the private sector. However, it is evident that current DLA's practice is proficient, particularly for commercial jet, and that substantive net savings would be unlikely.

FINDING:

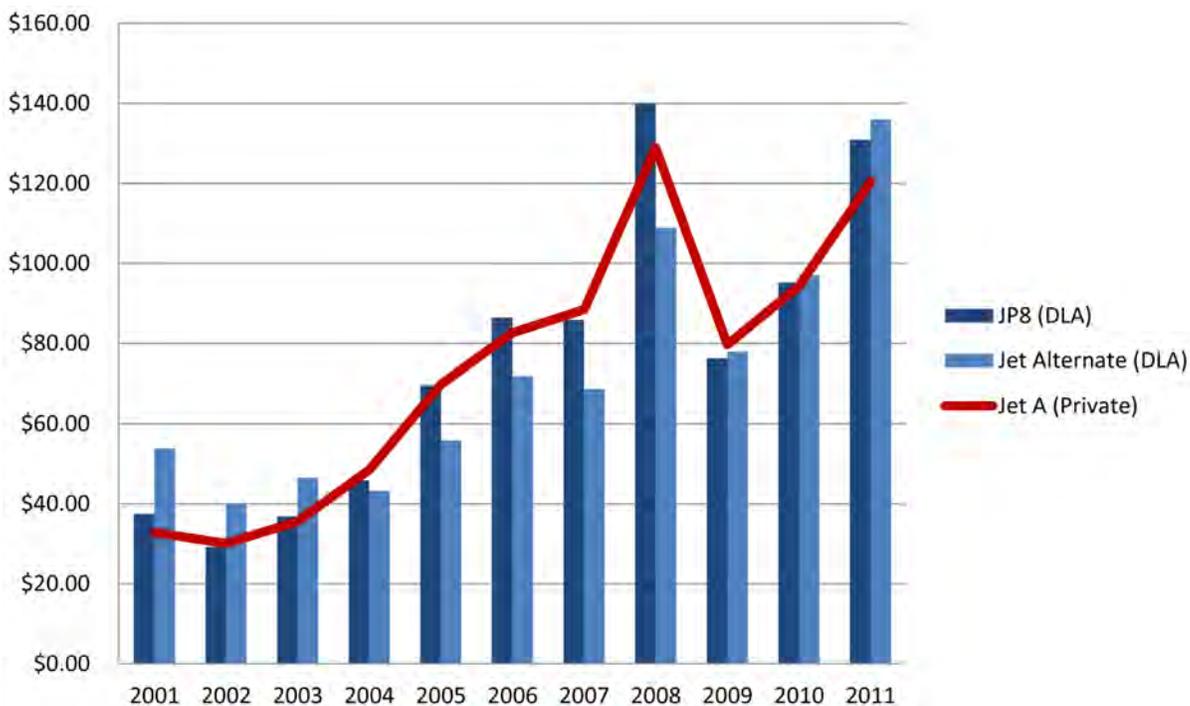
Fuel purchasing cost per barrel is comparable to the commercial sector. There is not major savings in reforming this process.

FINDING:

DLA purchased Jet Alternate Fuel an average \$1.03 less a barrel compared to the commercial purchases of Jet A.

FIGURE 1

ANNUAL JET FUEL COST PER BARREL



SOURCES: (1) DLA Fact Book (2) Airlines for America, Annual Crude Oil and Jet Fuel Prices

The Task Force finds that DLA will need to pursue other avenues outside of direct procurement reform if the Agency hopes to realize substantial budget reductions over the next five years. The greatest savings potential lies in the Agency's interactions with its customer base.

DLA's mission is to procure and supply fuel for the Services. And it is the Services that dictate the demand based on their own mission needs. However, the potential cost reductions realized from redirecting and/or reducing demand are noteworthy.

The Task Force concluded that DLA must take a more active role in monitoring, assessing, and guiding customer use of its fuel distribution network. Current budget mechanisms largely insulate the Services from the real cost of fuel – a cost that is then carried and absorbed by DLA. Through a system of information-gathering and targeted incentives modeled on Southwest Airlines' operational practice, DLA can drive more optimal distribution practice, achieving appreciable savings in the process. This recommendation is outlined by the Task Force in Section II.

FINDING:

Even in extremely volatile markets, a 1 percent annual reduction in demand could yield more than \$2 billion in reduced cost over five years.

Ultimately, however, **truly significant cost reduction for DLA-Energy will only come with reduced volume of demand**. The Task Force concluded that a 1% reduction in demand annually could yield over \$2 billion of a reduction in fuel budget in five years and \$5.6 billion of reduction by FY2020. These figures are forecast in an extremely volatile market that swings from \$120/barrel for fuel one year to \$80/barrel the next. The market is unlikely to be that volatile so the savings would likely be more measured, but this finding is nonetheless significant. No other reforms identified by the Task Force come close to this level of potential reduction in fuel budgets. Confronting the issue of demand will require shared sacrifice on the part of both DLA and the individual Services. In this new and austere budgetary environment, it will be a necessary task.

Section I

ANALYZING PRIOR RECOMMENDATIONS

Over the past year, consultants contracted by DLA proposed a series of recommendations aimed at creating greater efficiency within DLA-Energy's fuel operations. BENS was asked to assess these recommendations and provide insight on which ones promise the greatest rate of return. These initial recommendations were:

- Global purchases with 3-5 year contracts
- In markets/geographies with reliable supply, daily postings of commercial grade fuels
- Transition to commercial grade fuels
- Optimize supply, storage, and distribution network globally (DoD assets and commercial infrastructure)
- Lift guarantees with financial consequences/rewards
- Focused SRM and CRM practices in place
- Preferred providers supplying bulk of products at best-in-class pricing and terms
- 6-9 month procurement cycle
- Payment processing per industry standard

To address this assignment, the BENS Task Force examined each proposal and, using their experience and industry knowledge, weighed each according to possible savings and reasonable means of implementation. The Task Force was unable to obtain full descriptions of each proposal from the original consultants, nor did it acquire metrics used to value each recommended reform; it remains unclear if the consultants preferred certain measures over others.

GENERAL FINDINGS

The Task Force found that many of the prior efficiency measures recommended by DLA consultants are already being pursued or implemented. These include transitioning to commercial-grade fuel, reducing procurement cycles, and aligning payment periods to industry standards. While individually these measures carry only marginal or incidental savings, they will offer an appreciable impact if pursued in tandem. An overview and assessment of these recommendations is available in Table 1.

FINDING:

DLA is already moving forward on many of the efficiency opportunities recommended by their consultants.

Among these recommendations, transitioning to commercial grade fuel provides the highest level of savings. Others offer either low levels of savings, negligible savings, or undetermined level of savings. Levels of savings are described annually as:

- High = \$100 million or more
- Moderate = \$10 million - \$100 million
- Low = \$1 million - \$10 million
- Negligible = less than \$1 million

While pursuing annual savings in the thousands of dollars is admirable, the Task Force, in an effort to help DLA achieve billions of dollars in cost reduction, focused on recommendations that could reap significant savings.

The Task Force found that for many of the prior recommendations proposed, projected savings were difficult to quantify. For example, lift guarantees with consequences could encourage fuel suppliers to lower their bids one half cent per gallon because of the added supplier protection against a canceled contract. If that savings were attributed to every JP8 gallon purchased in a year, DLA could see a savings of around \$12 million.

FINDING:

Several proposed recommendations will provide savings, but savings would be minimal and difficult to measure.

However, in practice, each supplier values lift guarantees differently. Some current DLA suppliers may consider DLA a very reliable customer and build in less than a fraction of cent into a bid price as a financial protection against the possibility of a canceled contract. If that is the case then there would be very little savings and unless DLA determines the value of lift guarantees from each supplier explicitly, it would be difficult to determine the overall savings that recommendation could have. This is to say nothing of potential value lost if the Agency relinquished its right of unilateral, early contract termination.

Analysis for each consultant recommendation is provided in the following section.

Table 1 below summarizes the findings of each of the proposed recommendations made by DLA consultants.

TABLE 1

EVALUATION OF PRIOR RECOMMENDATIONS

FOR RECOMMENDATION	POTENTIAL FOR FURTHER ANNUAL SAVINGS	BENS ASSESSMENT	ALREADY IN PROGRESS
Global purchases with 3-5 year contracts	Negligible	DLA-Energy is obligated to budget the entirety of a multiyear contract up front; this negates potential savings . Select contracts already solicited on a multi-year basis.	✓
In markets/geographies with reliable supply, daily postings of commercial grade fuel	Negligible	In applicable regions, DLA-Energy already reflects daily market fluctuations . The Task Force does not see value in shifting further beyond weekly average postings standard.	✓
Transition to commercial grade fuels	Moderate	In addition to direct product savings, reduced MILSPEC use will expand available suppliers and allow consolidated DFSP storage; this initiative is underway and pending individual Armed Services review .	✓
Optimize supply, storage, and distribution network globally	Low - Moderate	DLA-Energy has launched initiatives to shift many of its DFSPs to contractor control ; however, DLA-Energy can only do so where it also demonstrates DoD-wide savings.	✓
Lift guarantees with financial consequences/rewards	Negligible - Moderate	DLA-Energy currently investigating raising lift guarantee from 75% to 90% ; as a gov agency, DLA-Energy must maintain a level of contract flexibility.	✓
Focused SRM and CRM practices in place	Negligible	Monthly demand projection updates will improve SRM practices ; DLA-Energy's CRM model is already excellent.	
Preferred providers supplying bulk of products at best-in-class pricing terms	N/A	"Preferred providers" list incompatible with open competition requirements and efficient execution of relevant federal mandates .	
6-9 month procurement cycle	Low	Currently average 9-month procurement cycle; DLA-Energy is in process of shifting contract quality/inspection requirements toward commercial standard , leading to further time savings.	✓
Payment processing per industry standard	Negligible	Adoption of web-based PORTS system has placed DLA-Energy payment processing on par with private industry and successfully reduced payment terms .	✓

ASSESSMENT OF EACH REFORM

Global purchases with 3-5 year contracts

DLA contracts currently are awarded annually and based on the lowest cost to the point of delivery. These contracts are typically fixed-price with an economic price adjustment (EPA) providing either an upward or downward revision depending on stipulations within the contract.⁷ Annual contracting is in line with standard commercial airline practice, but consultants believe the benefits of multiyear contracts, contracts for the purchase of supplies or services for more than a program year, but not more than five, could produce net savings for DLA.

The major benefit of multiyear contracting is in helping producers establish better sales forecasts and allocate refining capacity. Having a guaranteed buyer offers suppliers a better understanding of how much of their operations will be dedicated toward provisioning specialized, MILSPEC fuels. Multiyear contracts can also reduce administrative time requirements because there is no need to re-bid. Those benefits could entice a producer to offer a lower bid price to DLA and hence achieve savings for the Agency.

However, in practice, there are several major drawbacks for DLA to pursue multiyear contracting. The most significant drawback is that DLA is required by federal mandate to budget the entirety of the contract upfront. This requirement necessitates tremendous upfront expense and distorts DLA's budgets all while negating annual cost reduction goals. While there could be a small comparative savings realized over the course of a multiyear contract, this figure would be distorted by large spikes every year a contract is awarded.

Moreover, the majority of DLA fuel purchases are currently specialized MILSPEC fuel. Producers willing to refine MILSPEC fuel are not as abundant as those involved in more commonly used commercial fuels, and multiyear contracts would likely diminish the supplier pool further over time. The opportunity cost of multi-year, specialized MILSPEC contracts – tying down refining capability that would otherwise be used to capitalize on changing market conditions – poses its own set of challenges. DLA could actually experience an increase in cost per barrel as fewer producers choose to compete for awards.

Lastly, it is unclear if producers prefer multiyear contracts. In a meeting between senior DLA officials and fuel industry leaders

in Fall 2012, industry leaders expressed mixed feelings about the idea of multiyear contracts. Multiyear contracts are not standard industry practice for most airlines and many large fuel suppliers did not support moving toward the practice.

In general, the Task Force does not endorse this recommendation as it does not promise significant savings for DLA.

In markets/geographies with reliable supply, daily postings of commercial grade fuels

In an effort to eliminate potential supply inefficiency and ensure that the DLA takes full advantage of favorable price shifts, DLA consultants recommended that DLA-Energy use daily commercial fuel revisions as a price point for procurement operations.

However, this recommendation is already effectively in practice across certain geographic regions. Where possible, DLA-Energy's Economic Price Adjustment (EPA) mechanism considers daily shifts in oil indexes and regional markets. The agency monitors these price fluctuations and acts accordingly. This recommendation would be redundant.

In Section II, the Task Force does recommend pegging the EPA to New York Stock Exchange's RBOB Gasoline or HO Heating Oil futures or even discarding it entirely.

Transition to commercial fuels

Among the prior recommendations proposed, transitioning to commercial grade fuels promises the highest level of savings for DLA. It is estimated that once fully implemented, DLA could realize savings between \$25 million and \$37.5 million from current costs; the Task Force concurs with this assessment.⁸

The benefits of using commercial grade fuels over their MILSPEC counterparts include greater availability of fuel in the spot market, the ability to share commercial storage facilities, opportunity to reduce inventory levels where commercial grade is plentiful, and general reduction in overall fuel cost.

FINDING:

Transitioning toward commercial grade fuel provides the highest potential savings – over \$20 million annually.

Producers for DLA currently must develop products that are exclusive to the military, posing an opportunity cost as firms direct their refining capacity toward a specialty product. Eliminating the need to refine unique fuels would not only create even greater supply of commercial grade fuel; it would create savings for producers that would be shared by all buyers.

For example, MILSPEC-grade JP8 jet fuel is not commonly used by domestic airlines in the United States. The more common jet fuel in the United States is Jet A. The significant difference between the two fuels is the freezing point. Where JP8 has a freeze point of minus 47 degrees Fahrenheit, Jet A is minus 40 degrees Fahrenheit. This is a requirement for jet aircraft flying at high altitude, but may not be necessary for ground diesel, turbine or helicopter applications, especially with the use of additive injections

Similarly, production in the United States for F76, the primary ship naval fuel, has declined and its cost has risen with escalating environmental restrictions. The entire domestic distillate market has converted to ultra-low-sulfur-diesel (ULSD). Few refiners produce the higher sulfur F76 as they have invested significant capital to meet on-road diesel specifications. There is also a cost to maintaining two separate storage systems and discharge systems, and the risk of cross-contamination between grades of diesel is very high. An incredibly small amount of high-sulfur diesel can throw off the specifications on finished ULSD.

Use of commercial grade fuel removes logistical constraints such as the requirement for additional tankage for storing MILSPEC fuels. Freight charges accumulated for separate transportation would also be significantly reduced as fuel would be available at pipeline terminals rather than only at refineries. ULSD should be evaluated as a replacement for F76.

The burden for implementing the transition, with full implementation on an indefinite timeline and certainly beyond 2014, is incumbent upon the individual Services. The Services dictate demand and DLA is hindered until they require greater use of commercial grade fuel. Services set specification requirements based on engine design and mission requirements, and demand for specialized MILSPEC fuels will continue until the Services test and certify that commercial fuels satisfy

design and mission requirements. Unfortunately for DLA, that means potential savings will not be fully realized anytime soon. Studies are currently underway to assess transition away from MILSPEC JP8 and F76. The Services should, where practical, redesign engines to use commercial spec fuels, such as Jet A instead of JP8. Similarly, additive package specifications for military fuels should be evaluated for opportunities to use more common commercial specs. Reduced specialization will reduce costs.

DLA is already encouraging the Services to expedite their transition and should provide greater encouragement where possible. For example, DLA should evaluate whether the military needs tighter cold flow properties in all areas of the United States. In Northern climates, K-1 kerosene (Ultra Low Sulfur kerosene/jet) is mixed in diesel during the winter to prevent wax crystallization in the fuel. Proactively providing this type of analysis can lift the burden for the Services and expedite the transition.

Undoubtedly, there are certain to be equipment and applications where specialized specifications are necessary, but all opportunities to utilize commercial grade fuels should be identified and exploited.

Optimize supply, storage distribution network global (DOD assesta and commercial infrastructure)

Optimizing global assets and supply network should be, and already is, a goal for DLA. DLA currently oversees 407 distribution sites and roughly 600 Defense Fuel Support Points (DFSPs); with terminal operations and transportation accounting for approximately 4 percent of DLA-Energy's annual costs – \$777 million in FY2011.⁹

The Facility Management Division (Energy-NF) within DLA-Energy is charged with performing optimization studies to determine the most effective use of DoD fuel facilities as well as related transportation and storage systems. DFSPs are primarily government-owned, government-operated (GOGO) or government-owned, contractor-operated (GOCO), and among Energy-NF's priorities includes examining cost effectiveness of consolidating, privatizing, or outsourcing GOGO facilities.¹⁰ Energy-NF has already determined that there will be over \$200 million in savings over a twenty year period from transition to

either fully privatized or more GOCO facilities. 22 additional locations are being assessed for closure or reduction; DLA anticipates additional closure opportunities as the Armed Forces transition from JP8 to Jet A.

There are important caveats to this process. Assessed savings apply across all DoD: in many cases, DLA has assumed responsibility for DFSPs that raise the Agency's operating costs while *reducing* costs for the Department as a whole. Furthermore, 60 percent of DLA's inventory and associated storage is consumed by the Congressionally funded War Reserve Materiel (WRM), a contingency fuel reserve whose maintenance costs must be absorbed by DLA. Many potential opportunities for optimization remain beyond the Agency's ability to control.

Ultimately, the Task Force believes that reduction efforts should be continued and are pleased to find that DLA-Energy has a dedicated division for this task.

Lift guarantees with financial consequences/rewards

Another recommendation received from DLA consultants is the award of contracts that stipulate financial consequences for failure to honor lift guarantees. A lift guarantee is the amount of the total award that DLA ensures will be purchased. DLA currently commits to a 75 percent lift guarantee. However, DLA can cancel this contract at any point, forcing suppliers to make a claim against the government if they hope to recoup their losses. "Canceling for convenience," while seemingly beneficial to DLA, harms producers who have dedicated a portion of their operations to non-fungible fuel sources – MILSPEC fuels – that are difficult to sell to other buyers. Producers therefore increase their bid price as a hedge against the possibility of a canceled contract. That increased cost is passed on to DLA.

In theory, DLA can negate the increased cost by including a financial penalty or reward that addresses a producer's overage to cover a cancelled contract. The retribution provides a level of operational security for the producer and marginally lower bid prices for DLA. There could be realized savings of approximately one half cent per gallon which would equate to around \$12 million.

However, in practice, each producer values lift guarantees differently and many current DLA producers consider DLA a reliable customer. In the same meeting between DLA and industry

leaders cited earlier in this report, DLA suppliers expressed their favorable perceptions of the Agency. If DLA is considered a very reliable buyer, it is likely producers build in less than a fraction of cent into a bid price as protection against cancellation. The return for providing a financial penalty would therefore be negligible for DLA.

The Task Force ultimately believes there could be savings from this recommendation, but it is likely minimal and would assess an indefinite loss through loss of DLA's contractual flexibility. Indeed, the Agency requires the flexibility to change producers in order to meet unanticipated mission requirements. The institution of financial penalties would force policymakers to sub-optimize their operations in order to avoid financial recourse. Furthermore, this lack of flexibility could further negate savings by forcing policymakers to remain with higher cost producers.

In addition, DLA is already pursuing an initiative to increase their lift guarantees from a standard 75 percent to 90 percent. This move will likely strengthen DLA's reputation as a reliable buyer, which may further negate any potential savings.

Focused SRM and CRM practices in place

Another recommendation was for DLA to fully implement SRM (Supply Relationship Management) and CRM (Customer Relationship Management) practices. SRM and CRM are models for managing an organization's interactions with their supplier or customer base. Through these models, an organization develops strategies that are meant to optimize efficiency and reduce costs.

As an intermediary between private suppliers and Service customers, DLA-Energy would stand to gain by implementing such management procedures. In fact, DLA-Energy currently exercises an effective set of CRM procedures unique to its context as a government entity. It absorbs Armed Forces' budgetary risk through use of the Standard Price mechanism and carefully monitors Armed Forces' usage patterns. Using this data, the agency adjusts its distribution network to better meet customer needs.

The Task Force offers a spectrum of recommendations to bring DLA-Energy's SRM practices in line with this CRM success. While savings from these practices are not likely to save DLA more than several million dollars annually, the added efficiency is nonetheless appreciable. See Section II for an expanded list of suggested SRM practices.

Preferred providers supplying bulk of products at best-in-class pricing and terms

The potential benefits of preferred providers are reduced product cost and a more direct relationship with a producer. This practice is widely used by global enterprises and could provide significant savings by reducing the procedural steps from demand forecasting to bid solicitation and award. It can also drive deeper supplier discounting for long-time customers.

However, DLA must operate within the framework of a number of federal stipulations, including a requirement for full and open competition between bid-submitting contractors. Without major acquisition reform well above DLA's direct control, it is simply untenable for the Agency to generate a list of "preferred" providers.

While DLA can and should advocate for broader acquisition reform in the long term, the Task Force believes that the Agency's short term energies are best spent elsewhere. For example, effective SRM could achieve a similar de facto outcome as a preferred providers list without compromising DLA's federal mandates. The Task Force elaborates on such recommendations in Section II.

6-9 month procurement cycle

In an effort to more closely align DLA's purchasing and delivery practices with private industry practice, consultants recom-

mended that DLA reduce its inclusive procurement process to a six to nine month cycle. DLA currently takes roughly nine months to finalize its contracts and award bulk fuel solicitations. Staggered deliveries begin after this time, pushing the total procurement cycle well beyond a year. The extended period does pose a "time value of money" issue and reducing procurement would create greater efficiency and savings.

The Task Force recognizes that DLA operates within a unique set of institutional constraints – for example, the Agency cannot capitalize on excess capacity and cannot dictate levels of supply based on fluctuating prices. However, the Task Force nonetheless believes an accelerated awards process more closely aligned with private industry is worth pursuing. The Task Force elaborates on this recommendation in Section II.

Payment processing per industry standard

Similar to the previous recommendation, DLA consultants recommended that the Agency's payment processing practices should align with private industry. The idea is that expedited payment would improve supplier relations and exert a positive effect on the contract negotiation process.

DLA contract awards process currently lags behind the private sector; it takes roughly nine months to finalize a contract and award a bulk fuel solicitation. However, with the web-based PORTS system used by the Agency, the Agency's payment processing upon product delivery is highly competitive and already in line with industry standard.

While the Task Force applauds DLA's current payment processing standard, they do offer suggestions to shorten DLA's total bid cycle in Section II. Implementation of these practices should consequently reduce the Agency's billable hours and pricing uncertainty from the producer.

Section II

A PRIVATE SECTOR APPROACH

Section II focuses on practices the Task Force believes would improve DLA's fuel operations through cost reduction, optimized efficiency, and ensuring senior DLA leadership is successful in achieving their goals. It also addresses BENS' second tasking: provide private sector measures the Task Force would pursue if given DLA's structural and operational requirements.

There are four additional measures the Task Force advocates:

- Provide incentives that drive Service demand to DFSPs that are of lowest cost to DLA
- Encourage revision of "Standard Price" to develop more accurate budgeting
- Enhance supplier relationship management (SRM) which could lead to further savings
- Take advantage of change management practices that help senior leadership better ensure effective implementation of reforms

The following sub-sections describe each measure and provide DLA with a plan on how to implement each reform. While it is unlikely that these reforms will realize billions in savings over a five year period as originally desired by DLA, they will nonetheless improve overall fuel operations.

DRIVE DEMAND SIDE EFFICIENCY

Within the Department of Defense, procurement and operational arms are not coordinated. Fuel acquisition, storage, and distribution are administered by elements within DLA-Energy while the Services dictate actual patterns of fuel consumption. Accordingly, no matter how efficient the agency makes this procurement process, its costs are largely determined by end-use customers.

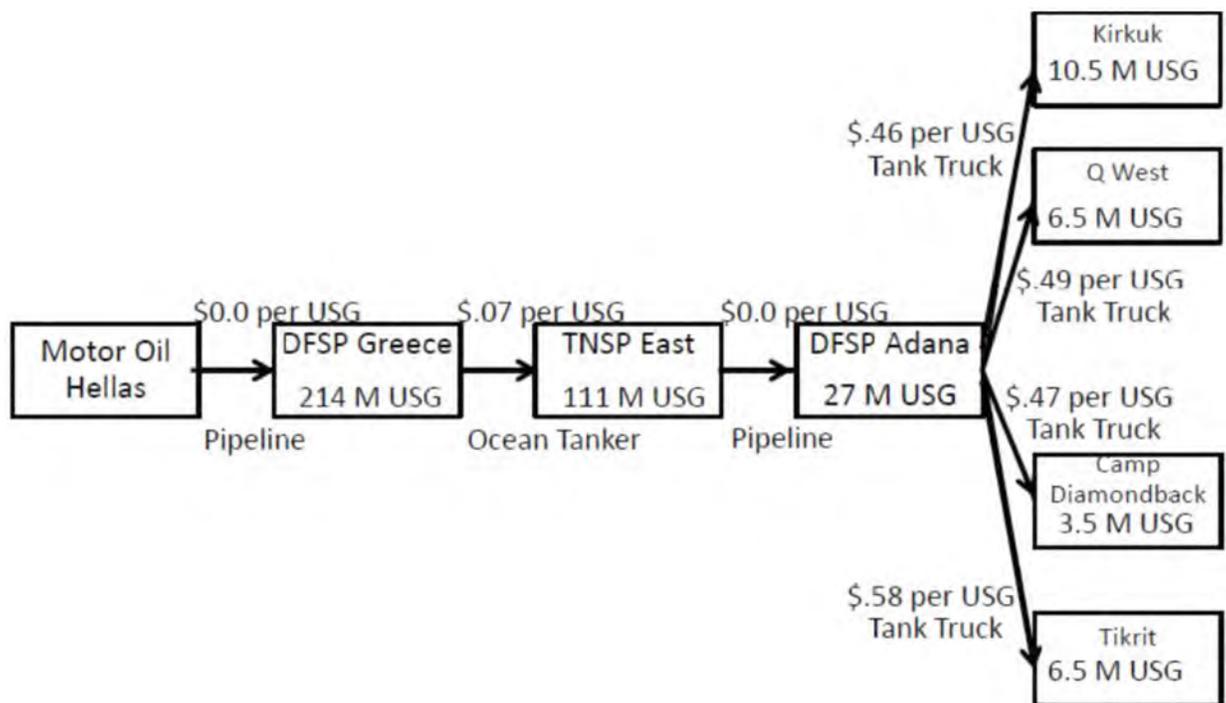
The Standard Price shields the Armed Services from awareness of the Fully Burdened Cost of Fuel (FBCF), which is the aggregate cost of procurement, transportation, storage, and distribution. To a Navy logistician, a barrel of JP5 acquired in Norfolk costs as much as one acquired in the United Arab

Emirates. While this system effectively simplifies operational planning for the Armed Services, it also raises costs for DLA-Energy. In reality, the FBCF differs – sometimes drastically – based on geographical location and specific context.

Because the FBCF is not represented in the buying process, the Services have no incentive to consider these costs in their operational planning. The consequences can be significant: one analysis found that the Standard Price represented only 30-50 percent of the FBCF in a maritime refueling scenario.¹¹ Without a mechanism to communicate the real price of fuel across each Defense Fuel Supply Point (DFSP), DLA-Energy is unable to encourage a cost-effective distribution strategy.

FIGURE 2

DELIVERY COST OF JP8 TO DFSPs IN IRAQ

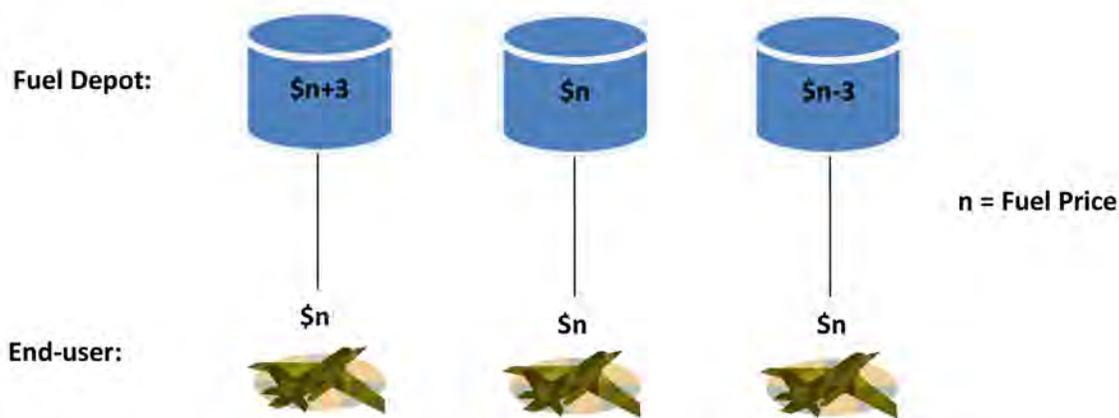


SOURCES: John W. Hills, “Fully Burdened Cost of Fuel Using Input-Output Analysis”, *Naval Postgraduate School Masters’ Thesis* (September 2011).

NOTES: This chart represents the transportation costs associated with a single fuel contract of a single fuel type across a single theater of operations. Because of standard price, end-use customers pay the same rate whether fuel is obtained at Kirkuk or Tikrit. The real FBCF is absorbed by DLA-Energy.

FIGURE 3

CURRENT FUELING PRACTICES BY DOD



DLA-Energy's current distribution network is focused on maintaining cost stability for its customers, and does not reflect the FBCF associated with individual DFSPs. End-users do not have incentives to efficiently use the distribution network. They pay the Standard Price, $\$n$, at each DFSP – regardless of actual costs incurred by DLA-Energy to deliver fuel to that point

This model stands in stark contrast to private

business practice. Southwest Airlines, for instance, maintains a close working relationship between its procurement and operational divisions. Flights are chartered and “topped off” at depots where fuel is relatively cheapest to obtain. In regions where the FBCF is higher, planes will avoid filling more of their tanks than absolutely necessary. As the FBCF of individual depots shifts, flight plans shift accordingly.

This continuous, two-way information sharing creates a detailed understanding of consumption habits. It makes Southwest Airlines both a better supplier and a more efficient end-user.

While this system is superior from a cost-savings perspective, it is not entirely applicable to DLA-Energy. Unlike a

FINDING:

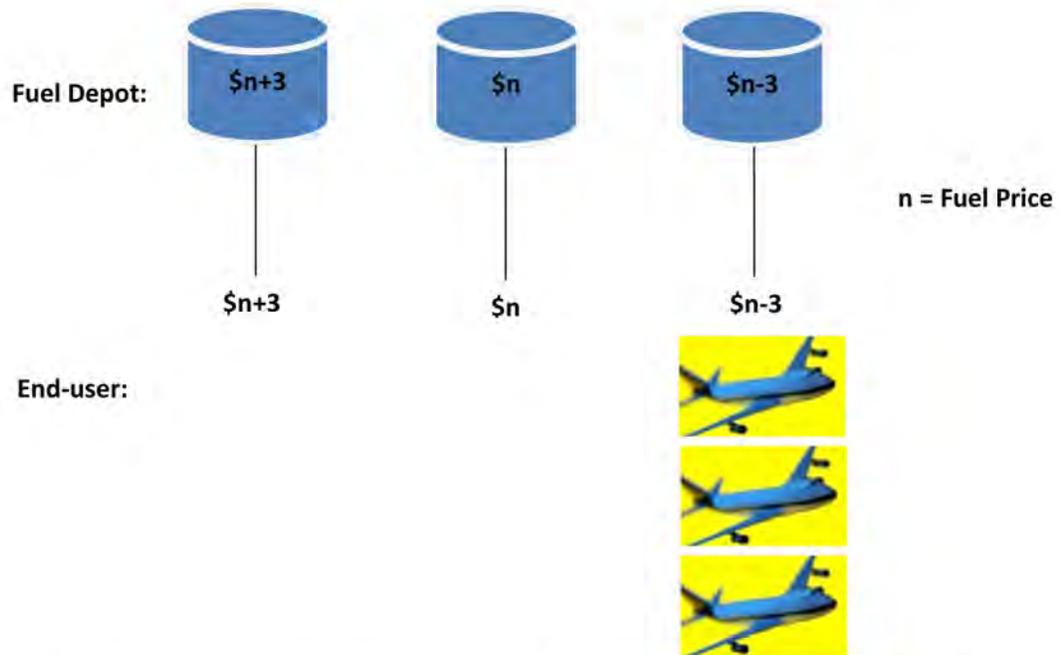
Disconnect between DLA fuel operations and Service demand is financially inefficient.

private sector entity like Southwest Airlines, DLA-Energy is not profit-driven. Its core mission is to efficiently provide fuel to its Armed Forces customers. These end-users are also independent: DLA-Energy does not exercise direct control over their operational planning or fuel use.

Nonetheless, the Task Force believes that elements of this private business model can be effectively applied to the way DLA-Energy interfaces with its end-use customers.

FIGURE 4

CURRENT FUELING PRACTICES BY PRIVATE SECTOR



Because procurement and operational arms of private enterprise are integrated, flight plans will mandate refueling at the depot with the lowest FBCF: in this case, $\$n-3$. The entirety of this savings is passed on to the end-user, and hence, the entire company.

A NEW APPROACH

Even within the Standard Price framework, it is possible to drive end-user demand toward the most cost-effective DFSPs with the cheapest FBCF. This can be accomplished with a fractional rebate system that encourages Armed Forces operational planners to utilize certain DFSPs over others.

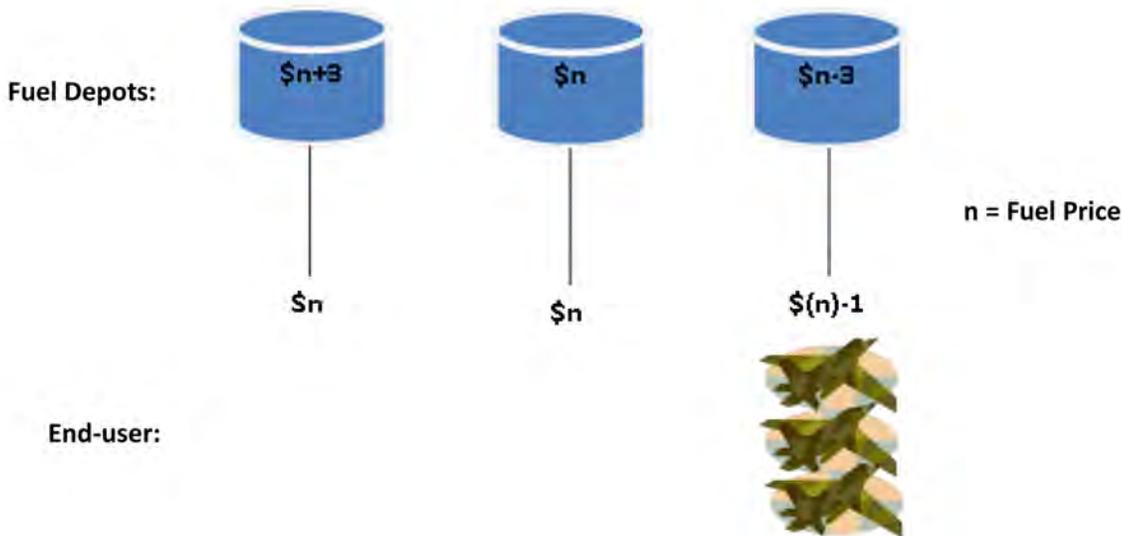
Under this proposed model, DLA-Energy does not interfere with the operational planning of the individual Armed Services – it simply creates new savings that end-users may choose to take advantage of where convenient. Although the BENS Task Force does not believe that cost should play a major factor in combat and contingency operations, there is ample opportunity for savings over the course of nonessential fuel

use. Routine training flights can be routed to take advantage of DFSP rebates; Navy squadrons can plot their refueling based on differential costs of nearby DFSPs.

Moreover, much of the data necessary to determine relative DFSP cost is already available. The Business Systems Modernization-Energy (BSM-E) logistics support system provides fuel receipt tracking over each DFSP. DLA-Energy conducts regular cost reviews of transportation arcs and nodes. Combining this information to determine cost-effective DFSPs – and appropriate fractional rebates – will not pose an infeasible administrative burden. It will, however, offer real demand-side savings for DLA-Energy as a whole.

FIGURE 5

PROPOSED FUELING PRACTICE



By providing marginal savings to the Armed Services, DLA-Energy can incentivize demand toward DFSPs with the lowest relative FBCF. This does not contradict the standard price or existing departmental regulation. In this example, the Armed Services receive a rebate *beyond* the Standard Price, $\$n$, but *less* than the total savings enjoyed by DLA-Energy at the specific DFSP. This system creates both supply-side and demand-side savings.

FOUR STEPS TO IMPLEMENTATION:

1. **Determine individual DFSP demand, capacity, and FBCF.** DLA-Energy should conduct a comprehensive review of the current use, capacity, and aggregate cost (regional procurement, transportation, storage, and distribution) of each DFSP within Agency responsibility. This data should already be available.
2. **Offer scaled, marginal REDUCTION in pricing at select DFSPs, based on FBCF.** Following review, the average FBCF should be determined and facilities performing below this figure should be identified. The most cost-effective, underutilized DFSPs should offer fractional reimbursements to their Armed Services customers that place real cost **BELOW** that of the Standard Price. So long as this rebate is less than the difference between average FBCF and cost of the specific DFSP, DLA-Energy will achieve net savings.
3. **Update this pricing mechanism on a MONTHLY basis, following changes in aggregate cost.** Metrics should be established and dynamically updated to reflect (and allow further anticipation) of changes in DFSP use. Marginal reimbursements can be shifted to drive Armed Services customers to those DFSPs that will return the most value to DLA-Energy.
4. **Accelerate reduction or deactivation of underutilized DFSPs.** Once usage and FBCF metrics have been established and projected over a reasonable period of time, DLA-Energy can take steps to intelligently reduce/deactivate underperforming DFSP facilities within the constraints of housing the WRM and other overseas contingency requirements. This will lead to further reduction in overall costs.

REFORM THE STANDARD PRICE

DLA-Energy's Armed Services customers pay a standardized rate for fuel products. The product cost component of this Standard Price is derived by OMB to agree with the President's Council of Economic Advisors' estimates for future crude oil costs. The crude price is then "marked-up" by a DLA-Energy average-historical-cost percentage that represents the expected difference between DLA-Energy's cost of refined petroleum products versus base crude oil. The Office of Secretary of Defense (Comptroller), with input from DLA-Energy through DLA-Finance, then sets the composite standard price to reflect the estimated refined-product costs and budgeted/estimated non-product costs to include transportation, storage, facility maintenance, and operations: the FBCF.

The Standard Price is intended to serve two purposes:

1. **Budgeting Consistency.** In theory, the Standard Price brings stability to the Armed Services' fuel budgeting process, shielding them from market volatility. However, the Standard Price has recently begun failing to perform this function. Thanks to disruptive revisions, the figure has sometimes shifted dramatically over the course of the fiscal year. In 2008, the Standard Price ballooned 76 percent by year's end. In 2012, it had done the opposite, shrinking by 59 percent. These fluctuations disrupt the budgeting of the Armed Services.
2. **DCWF Solvency.** In theory, the Standard Price ensures that DLA-Energy remains revenue-neutral, allowing the Defense Capital Working Fund (DCWF) to break even. In practice, DLA-Energy has increasingly required cash infusions in order to remain solvent. This has occurred either through OSD via Congressional appropriation or via substantial mid-year Standard Price revision. The cost-projection mechanisms that govern the Standard Price have proven mismatched for their intended function.

FINDING:

Budgeting practices are not consistent with commercial norms.

This inconsistency creates considerable budgeting inefficiency. In fact, rather than mitigate price volatility, in recent years the Standard Price has created additional volatility for both DLA-Energy and its Armed Services customers. Over the course of their examination of DLA-Energy procurement and distribution practices, Task Force members have repeatedly identified the Standard Price as the "weak link" in the agency's hybrid public-private business model.

TABLE 2

STANDARD PRICE ADJUSTMENTS FY 08-13

Fiscal Year	Effective Date of Standard Price	Standard Price (Per Barrel)
2013	10/1/2012	\$156.66
2012	7/1/2012	\$97.02
	6/1/2012	\$151.20
	1/1/2012	\$160.44
	10/1/2011	\$165.90
2011	6/1/2011	\$165.90
	10/1/2010	\$127.26
2010	7/1/2010	\$98.28
	1/1/2010	\$118.44
	10/1/2009	\$116.76
2009	9/1/2009	\$89.46
	4/1/2009	\$60.48
	2/1/2009	\$69.72
	12/1/2008	\$104.58
	10/1/2008	\$170.94
2008	7/1/2008	\$170.94
	12/19/2007	\$127.68
	10/1/2007	\$97.02

Source: DLA-Energy

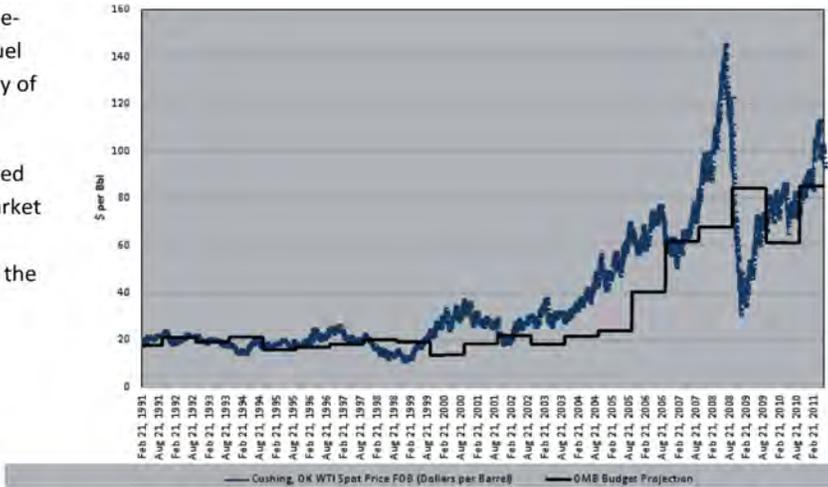
Notes: Because of oil price volatility in the years following 2008 – and a decrease in available supplemental funding – the Standard Price has seen large mid-year revisions to restore balance to the Defense Capital Working Fund.

FIGURE 6

OMB FUEL PRICE PROJECTIONS VS. ACTUAL MARKET PERFORMANCE

Source: Defense Business Board, “Re-examining Best Practices for DoD Fuel Acquisition,” Report to the Secretary of Defense (FY 11-06).

Notes: OMB projections have enjoyed only a tangential relation to real market behavior. This directly impacts the relevance and yearly consistency of the Standard Price.



A NEW APPROACH

Although the BENS Task Force understands DLA-Energy’s limited institutional involvement with Standard Price formulation, the Task Force nonetheless recommends increased intra-departmental pressure to give DLA-Energy added input into this process.

- **DLA-Energy is best positioned to inform a more accurate Standard Price pegged at the beginning of the fiscal year.** As the fuel procurement arm of DoD, DLA-Energy interacts closely with both private market suppliers and its public customer base. It is an opportunity to apply this expertise to the annual Standard Price formulation.

- **DLA-Energy can assess the true impact of adopting a more elastic pricing system.** The agency is currently in the process of implementing a moving average price (MAP) plus surcharge for non-military DLA-Energy customers. DLA-Energy should study the relative stability of the MAP system: the MAP’s limited elasticity may provide more stability than the Standard Price’s unpredictable history of revisions.

Ultimately, the Standard Price serves as a significant barrier to DLA-Energy’s overall operational effectiveness. Until this budgeting mechanism is reformed, the agency’s operational effectiveness will be negatively affected.

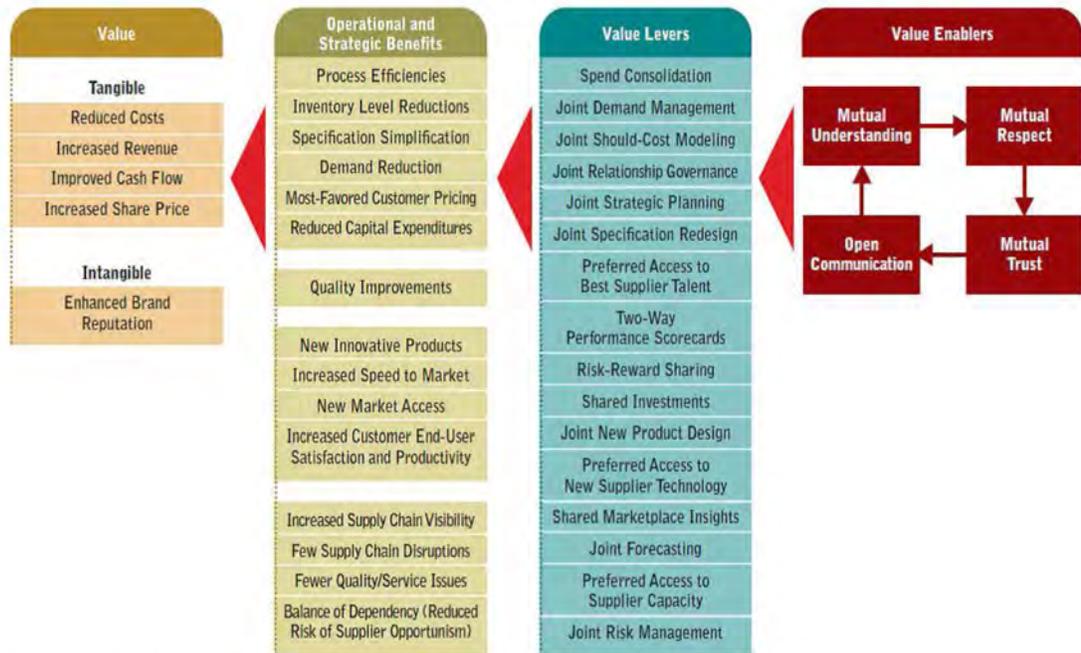
IMPROVE SUPPLIER RELATIONSHIP MANAGEMENT

DLA-Energy's supplier engagement practices differ considerably from those of private enterprise. Due to federal regulation, DLA-Energy is bound by the requirements of full and open competition. All contracts must be re-solicited, typically on an annual basis. The agency must also fulfill all federal acquisition guidelines. These restrictions limit DLA-Energy's procurement operations, but they are the constraints within which the agency must operate.

Despite the weight of federal regulation, the Task Force believes that DLA-Energy can improve its supplier relationship management (SRM). While DLA-Energy cannot directly emulate the SRM of private enterprise, the agency can apply SRM principles within its unique organizational context.

TABLE 3

FRAMEWORK FOR CREATING SRM VALUE



Source: Jonathan Hughes and Jessica Wadd, "Getting the Most Out of SRM," *Supply Chain Management Review* 16.1 (Jan/Feb 2012).

Notes: Representation of link between SRM initiatives and consequent returns. Some, though not at all, of these principles are applicable to DLA-Energy.

A NEW APPROACH

The Task Force has identified five initiatives that DLA-Energy can undertake to improve its SRM practices. The potential cumulative value of these proposals is substantial: a recent study of 100 Finnish firms demonstrated a strong, positive relationship between effective SRM and overall business efficiency.¹² In turn, this improved operational efficiency leads to increased – though indirect – financial performance. These proposals are arranged by their place in DLA-Energy’s procurement process.

1. **Shift contract pricing basis to New York Mercantile Exchange (NYMEX).** DLA-Energy currently evaluates contracts with the Economic Price Adjustment (EPA) mechanism that reflects the difference between the award price and the index price, drawn from published indexes like *Platts* or *OPIS*. The contract’s adjustment mechanism fluctuates with market rates and regional price shifts.

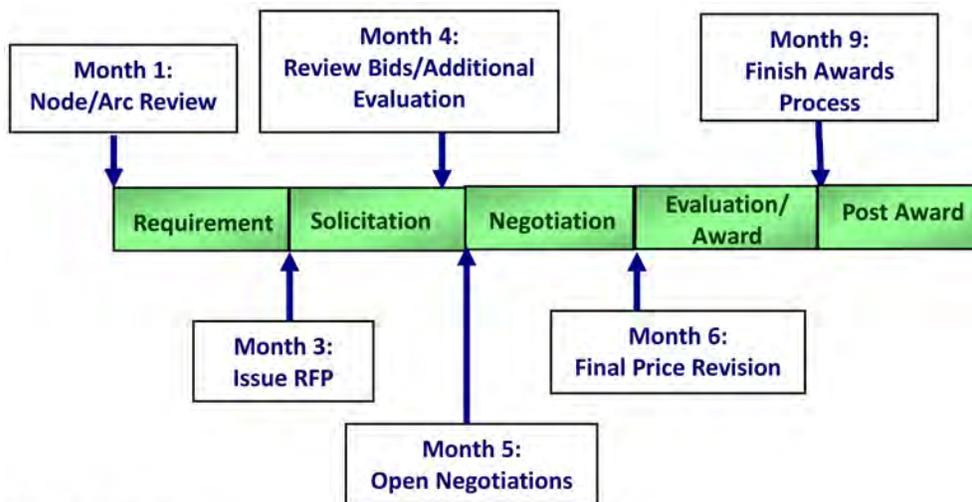
This system is cumbersome for CONUS suppliers, where the EPA – pegged to regional markets – can change daily. *In such situations, it is unclear what advantage the EPA mechanism provides over simple NYMEX-pegged pricing, based on RBOB Gasoline or HO Heating Oil futures.* The NYMEX provides standard pricing basis for private industry procurement and makes the price evaluation process simpler for the supplier. The Task Force recommends DLA-

Energy adopt a similar practice, pegging its moving price directly to the NYMEX in applicable markets. Doing so will reduce the computational workload of regular, CONUS DLA-Energy suppliers.

2. **Consolidate contract solicitation package.** All potential DLA-Energy suppliers must submit a roughly 50-page bid application through the FEDBIZOPPS online repository. *Task Force members with DLA-Energy supplier experience have voiced their dissatisfaction with the length, expectations, and redundant questions embedded in this solicitation package.* They observe that the average DLA-Energy bid runs 40-50 pages, compared to <5 pages for private market equivalent, and discourages some producers from bidding. This is particularly the case for situations in which bid applications must be reviewed by a company’s legal team. DLA-Energy has already identified this as an area of potential reform; the Task Force agrees with this assessment.
3. **Reduce time to contract award.** A regional DLA-Energy contract award cycle takes roughly nine months to complete, from preliminary review process to final settlement. These solicitations are conducted on a year-round, rolling basis.

FIGURE 7

DLA-ENERGY BID SOLICITATION & AWARD TIMELINE



Source: DLA-Energy

Notes: A complete bid solicitation cycle, from requirements determination to final award, takes roughly nine months.

This bid cycle is unacceptably long when compared to standard private enterprise practice which is intra-day. The Task Force recommends a condensed Node/Arc Review that more efficiently utilizes previous-year data: this will save DLA-Energy resources across its total billable hours. Furthermore, the Task Force recommends a thorough intra-agency examination of delay causes between final price revision and actual contract award. DLA-Energy suppliers spend too many months uncertain about final pricing, production planning, and transportation arrangements. Their bid pricing reflects this transferred risk.

Specifically, DLA-Energy suppliers expressed their frustration to the Task Force about “months of silence” that must be anticipated once a bid is submitted. Suppliers offset this lost time and resources by raising total prices by a minimum of 1-2 cents per gallon and often more. Reducing the period from solicitation to final contract award will create appreciable savings for DLA-Energy and potentially increase the Agency’s pool of willing suppliers.

4. Improve carrier selection and coordination.

Through use of the Transportation Rate Information System (TRIS), DLA-Energy conducts annual node/arc and rate reviews with the aim of fulfilling its logistical objectives at the lowest total cost. Bids are assessed and awarded only after significant consideration of transportation rates and availabilities. Regional offices supplement this assessment with monthly tender costs drawn from the Government Freight Management System (GFM) of United States Transportation Command (USTRANSCOM). This allows DLA-Energy to capitalize on cheapest available rates, but it also places additional burden on both carriers and suppliers, who must prepare for sudden changes in transportation arrangement.

According to conversations with DLA-Energy suppliers, it remains their responsibility to coordinate approved carriers for product pickup and delivery. As carriers post rate changes in GFM, DLA-Energy can shift contract designation to make use of advantageous shifts. These new designated carriers are passed on to suppliers, who must sometimes scramble to make their own logistical changes. This in turn creates waste and introduces increased uncertainty to the transportation process.

The Task Force recommends that DLA-Energy take additional steps of assessment before committing to any unanticipated, significant carrier changes. *What is most immediately lucrative for the Agency is not always most cost-effective in the long term.* Feedback given to the Task Force suggests that both suppliers and carriers build this risk factor into their estimates. The cost is indirectly transferred to DLA-Energy, creating poor SRM and sub-optimal pricing.

5. Share refined demand projections with suppliers.

Effective two-way communication is a pillar of successful SRM. This is true particularly for DLA-Energy, where indefinite lift guarantees and government’s reserved right of “Termination for Convenience” create adverse supplier conditions. While the BENS Task Force understands the strategic necessity of these contract conditions, it nonetheless recommends that DLA-Energy take additional steps to mitigate perceived supplier risk.

One significant risk mitigation initiative is already underway. DLA-Energy has communicated plans to raise its minimum lift guarantee from 75 percent to 90 percent on awarded contracts. The BENS Task Force anticipates that this will have a positive impact on supplier confidence and lead to gains in overall efficiency.

As an additional step toward improved SRM, the BENS Task Force recommends that DLA-Energy refine its sharing of year-total demand projections with current suppliers. According to dialogues held by the BENS Task Force, suppliers perceive DLA-Energy as a relatively opaque customer: the agency’s demands are difficult to anticipate and therefore plan for. Although – by its very nature – many of DLA-Energy’s needs are unforeseen and contingency-oriented, the agency should still strive to keep its suppliers closer “in the loop.” While DLA-Energy attempts to share tanker-supply forecasts three months in advance, much less lead time is permitted for pipeline and truck-bound orders. The Agency should seek to revisit and refine this notification process. This will lead to a closer customer-supplier relationship, improved SRM, and better overall price value.

PROVIDE CHANGE MANAGEMENT PRACTICES

Senior military leaders and defense officials are not just facing a short term demand for reduced spending, but are actually facing a multi-year requirement for significant yearly cost reductions. As such, DLA faces a major challenge in shifting the focus of its senior leadership from support of the warfighters to one that continues to deliver that high level of support while reducing cost.

In transitioning to a leaner operating environment and implementing corresponding operational changes, DLA's senior leadership should look increasingly to private enterprise practices for managing this shift.

FINDING:

Senior DoD Officials are facing new challenges and responsibilities in today's austere fiscal environment.

A NEW APPROACH

Past BENS experience has shown that when a careful and thoughtful process is used to select the BENS executive mentor to be paired up with a specific senior military leader, a new significant resource is provided to military leaders as they lead their organizations through change. All discussions between military leaders and mentors are completely confidential and will not be shared with anyone by the mentor.

The executive mentors selected would first meet with the military leaders they have been chosen to work with; if the chemistry is right, they would then schedule short meetings on a monthly basis. This relationship would continue for 12 months.

The Task Force recommends that VADM Harnitchek select three to five of his senior leadership who would benefit from

When Fortune 500 companies have to make major adjustments to the way their executives manage, many CEOs engage another senior executive to advise them personally. The senior executive is usually someone who has led other organizations through a similar change or an executive mentor who advises CEOs and presidents of companies.

The CEOs use the Executive Coach to discuss in a safe and confidential environment strategies that he or she is considering, ask for creative solutions to business issues that have to be resolved quickly, and sometimes solicit advice on how to deal with complicated personnel issues within their organization. The focus of the discussions is always on the real world experience the executive mentor has had in running large, complicated organizations and how it may apply to the issue being discussed.

having a personal executive mentors, and in kind, BENS would provide a list of potential senior-level executive mentors with biographies to discuss possible pairings.

The benefits of this enterprise to provide DLA senior leadership with a safe and confidential environment to discuss strategies under consideration provide outside perspective and creative solutions to business issues that have to be resolved quickly, and offer advice on how to deal with complicated personnel issues within their organization.

We propose leveraging the executive mentoring capabilities already established through the *BENS Mentor Program*. These capabilities would be expanded to provide DLA with private sector guidance through the suggested changes.

EIGHT STEPS TO IMPLEMENTATION:

1. BENS appoints DLA Mentoring Program Leaders. One of the Program Leads is to be both a senior level business executive and member of BENS. The other Program Lead is to be a BENS staff member.
2. Program kickoff meeting with VADM Harnitckek to discuss which three to five senior DLA leaders would participate in the program. Discuss key attributes required of the executive mentors to meet the senior leaders' distinct needs.
3. VADM Harnitckek appoints a DLA executive mentoring sponsor within DLA.
4. BENS Program Leaders solicit appropriate executive mentors and provide VADM Harnitckek and the DLA executive mentoring sponsor with their biographical information.
5. Following approval of the executive mentors, the BENS program leaders coordinate with the DLA executive mentoring sponsor to introduce the three to five military leaders and their respective executive mentors.
6. BENS program leaders meet with the executive mentors to ensure that they understand their roles and goals for the coaching effort.
7. Each executive mentor meets with their respective military leader to ensure the right chemistry exists between them and to start the coaching work.
8. A review of the progress and success of the coaching program will be performed by the DLA executive mentoring sponsor and the BENS program leaders each quarter. A progress report will be provided to VADM Harnitckek each quarter. The progress report will provide an overview assessment of the mentoring relationship, although specific topics and conversations will remain confidential.

Conclusion

Within supply-side operations, DLA enjoys several opportunities to reduce its overall expenditures through efficiency measures applied to their fuel procurement and distribution practices. Many improvements are being pursued or implemented already, while others could be initiated.

Among the measures already underway, transitioning to commercial grade fuel provides the highest opportunity for reducing cost. It is estimated DLA will save over \$20 million dollars through reduced reliance on JP8 and other MILSPEC grade fuels. Although the transition to commercial grades is largely incumbent upon the individual Services, it is strongly in DLA's interest to encourage acceleration of these efforts.

Additional recommendations within DLA's supply-side function include enhanced supplier relationship management and utilizing change management practices to help DLA's senior leadership articulate and meet their goals.

Recommended changes to DLA's demand-side interactions offer also significant cost reduction opportunities. These include incentivizing the Services to refuel at cost-advantaged DFSPs to improve fuel distribution efficiency and a revision of Standard Price formulation to develop a more accurate budgeting process.

Although the impact of these measures is individually marginal, they present an opportunity for real and appreciable savings if pursued in tandem. The BENS Task Force strongly endorses these proposed initiatives and wishes DLA the best in its continued efficiency efforts.

Appendix

ROI OF HEDGING FUEL PRICE RISK MANAGEMENT FOR DLA-ENERGY

During the course of their analysis, the BENS Task Force explored private sector procurement practices, particularly hedging, and their applicability to DLA-Energy's buying practices. While this assessment was beyond the immediate scope of VADM Harnitchek's request, it was germane to broader questions raised by the Agency's daily market interactions.

When private companies hedge, they convert a portion of their commodity purchase to a fixed price point they believe will be lower than the projected average. This is done in an attempt to mitigate risk posed by a volatile marketplace.

Hedging is common in fuel procurement: the airlines have used hedging to occasionally great success. Southwest Airlines through 2008 increased revenue by hundreds of millions of dollars through savvy hedging practices. However, following the 2008 price crash, airlines suffered massive losses and consequently reduced their hedging commitments. They have not returned to pre-2008 levels.

In the public sector, due to the need for optioned hedging to avoid catastrophic loss, it is more difficult to effectively employ hedging. Even a small deviation below projected market averages will lead to a net revenue loss.

DLA-Energy does not currently hedge. Its contracts have a base cost, with daily or weekly price adjustments based on market fluctuation.

DLA-Energy's adoption of hedging would lead to budget stability and overall price risk mitigation. It also finds precedent in both private enterprise and in the buying practices of other nations' defense departments.

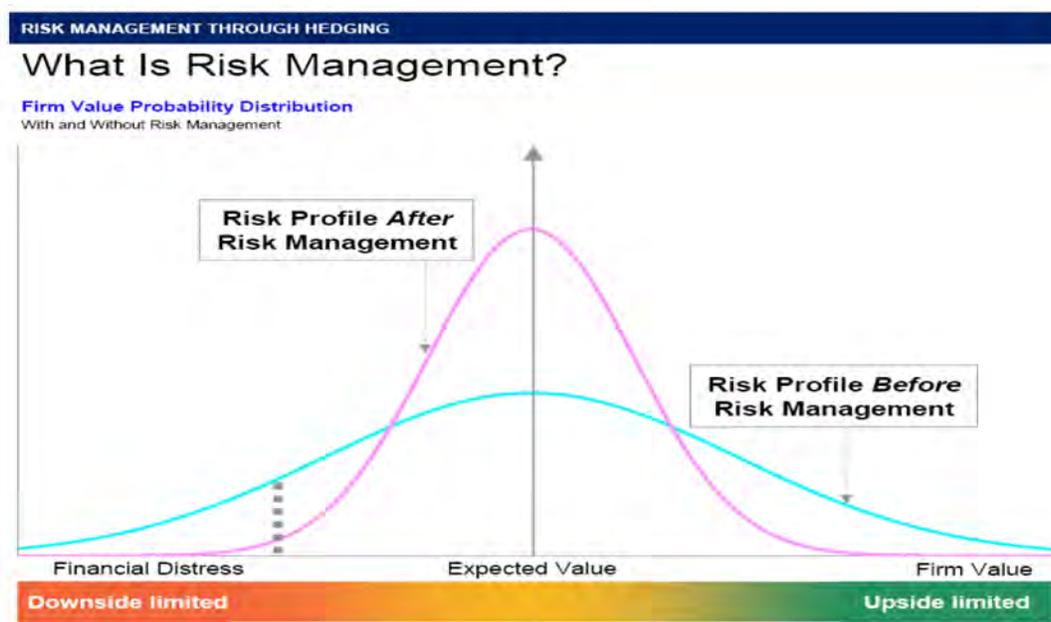
However, DLA-Energy's adoption of hedging limited overall ROI and the chance for budgetary catastrophe. It also countermands federal small business requirements and complicates transportation estimates. Finally, it entails a high degree of political risk.

Ultimately, hedging offers only marginal progress toward the goal of reduced DLA-Energy procurement costs.

OVERVIEW

Hedging is an investment position intended to offset potential losses/gains that might be incurred by a companion investment. It is a price-setting commitment that reduces overall financial volatility. Specifically, fuel price risk management is a cyclical process whereby companies limit their exposure to costly changes in fuel price (i.e., unanticipated Middle East instability). After company demand is forecast, risk is evaluated in terms of exposure to price fluctuation and a calculation of price trends based on oil futures or some other benchmark. If the situation warrants, the company **hedges** by offsetting the purchase with floating prices by selling financial contracts with offsetting floating prices for the same pricing period, effectively locking in a fixed price for the physical purchase.

The result is mitigated financial volatility. If the price of fuel rises unexpectedly, the company enjoys a degree of insulation. *However, if the price of fuel drops lower than the hedged position, this leads to net financial loss.*



Source: Morgan Stanley Global Commodities Group

Notes: The dotted vertical line represents the hedged quantity. Hedging offers a net benefit so long as the average market value slightly exceeds the hedged price.

HEDGING IN THE PRIVATE SECTOR

Hedging is a common private sector practice. Moreover, fuel price risk management has been used to great success in the procurement process of major airlines. However, **thanks to large significant financial losses by some participants when the markets reversed in 2008, hedging is used more cautiously by many.**

Southwest Airlines offers a case study in the benefits – and risks – of hedging. In 2004, Southwest saved \$63 million dollars thanks to fuel price risk management. The airline hedged roughly 80 percent of its total fuel buy; nearly twice

that of its peer competitors.¹³ Accordingly, when the price of fuel jumped nearly 50 percent in three months, Southwest remained largely unaffected. Such success made the airline's hedging practice a business school case study and a powerful argument in favor of fuel price risk management.¹⁴

However, Southwest's aggressive hedging strategy proved disastrous with the collapse of the 2008 oil bubble. Oil reached a high of \$147/barrel in July 2008 before crashing down to \$30/barrel by the end of the year, making it one of the biggest commodity busts in history. Southwest's number of "long,"

multi-year hedges – locked in at rates negotiated at the height of the commodity bubble – suddenly became a serious financial liability. Southwest reported a \$120 million dollar net loss in Q3 2008.¹⁶

Airlines drastically reduced their hedged positions in the aftermath of the 2008 price crash. They have avoided excessive fuel price risk management in subsequent years, even as the price has begun to normalize. Although hedging remains a useful tool against price volatility, it is hardly a “silver bullet” in ensuring company profit margins. Its net revenue performance is unclear.¹⁷

Price per gallon (PPG) with and without hedging and percent hedged as reported in the 2008 10-K for selected U. S. carriers

	PPG (w/hedge)	PPG (w/o hedge)	% Hedged in 2009
American	\$3.03	Not available	35.0%
Continental	\$3.27	\$3.17	23.0%
Delta	\$3.16	\$3.14*	48.0%
Airtran	\$3.25	\$3.21*	9.1%
Alaska	\$3.95	\$3.31	50.0%
United	\$3.54	\$3.26	34.0%
Frontier	\$3.11	\$2.99	0.0%
Hawaiian	\$3.17	\$3.14	24.0%
Southwest	\$2.44	Not available	10.0%
US Airways	\$3.17	\$2.86*	14.0%

Source: Robert Brooks, “A Life Cycle View of Enterprise Risk Management: The Case of Southwest Airlines Jet Fuel Hedging,” *Journal of Financial Education*, Vol. 38, No. 3/4 (2012)

Notes: The 2008 oil bubble had serious adverse effect on airlines’ hedged fuel stock. Hedging dropped considerably for FY 2009.

Oil Price Evolution

ICE Brent Crude Oil

ICE Brent front month vs. historic forwards

\$/bbl



Source: Morgan Stanley Global Commodities Group

Notes: Although pricing has regained some stability in the aftermath of the 2008 oil bubble, volatility remains high. In this uncertain commodities environment, airlines are disinclined to match their pre-2008 investments in hedged pricing.

HEDGING IN THE PUBLIC SECTOR

Hedging, specifically fuel price risk management, is less commonly utilized in the public sector. This is because, even if the mechanisms of hedging remain the same, **the financial expectations and obligations of public sector entities are fundamentally different from their private sector counterparts.**

Government budgets are approved only after revenues and expenditures have been delineated, estimated, and debated.¹⁸ Because of this, mid-year budget deficits are a fact of life for agencies involved in the unpredictable fuel procurement market. Politicians typically react to deficits by either increasing taxes, decreasing planned expenditures, or using debt to finance the shortfall. Each of these choices carries heavy political costs: accordingly, hedging would appear to be an attractive alternative.

In practice, however, public sector hedging is more complicated. Government entities must almost inevitably engage in

optioned hedging (call option), in which the hedging party is not “locked in” to the agreed-upon price. Otherwise, a steep drop in prices would heavily undermine the government’s political support as taxpayers felt their money being speculated and wasted. Yet optioned hedging also carries a premium. This raises the challenge of making the hedge profitable. A model of optioned hedging applied to Texas state revenues found that the option reduced revenues by 2.6 percent.¹⁹

This same study also found that when the government’s anticipated oil prices differed from the true distribution – nearly always the case – optioned hedging offers ambiguous benefit.²⁰ A large and unanticipated rise in fuel prices resulted in savings of as much as 30 percent over the unhedged differential. However, if the price fell, optioned hedging resulted in losses 65 percent more than the unhedged differential. **In the case of poor market projection, the risk of optioned hedging outweighs its potential rewards.**

Impact of OMB Budget/Actual Price Disparity

FISCAL YEAR	Crude - OMB BUDGET PROJECTION (\$/BARREL)	Crude - ACTUAL (\$/BARREL)	Crude - ACTUAL as % of OMB BUDGET PROJECTION	BARRELS OF REFINED PRODUCT SOLD (MILLIONS OF BARRELS)	ESTIMATED DOLLAR IMPACT ON REFINED PRODUCT COST (MILLIONS OF DOLLARS)	WHAT HAPPENED
1992	\$ 21.32	\$ 18.26	86%	146.2	\$ (608.78)	Budget Year prices adjusted
1993	\$ 19.30	\$ 17.21	89%	140.8	\$ (395.00)	Budget Year prices adjusted
1994	\$ 21.28	\$ 14.89	70%	127.9	\$ (1,313.23)	Appropriation Act transferred (\$5.6 billion)
1995	\$ 15.86	\$ 16.99	107%	122.0	\$ 192.28	Appropriation Act transferred \$1.1 billion
1996	\$ 16.99	\$ 19.04	112%	120.1	\$ 349.11	Budget Year prices adjusted
1997	\$ 18.16	\$ 19.93	110%	111.7	\$ 272.77	Budget Year prices adjusted
1998	\$ 20.09	\$ 13.77	69%	112.3	\$ (1,046.35)	Supplemental Act transferred (\$5.7 billion)
1999	\$ 19.19	\$ 14.22	74%	112.5	\$ (833.35)	Appropriation Act transferred (\$1.1 billion)
2000	\$ 13.77	\$ 26.37	191%	107.7	\$ 1,721.76	Supplemental Act transferred \$1.6 billion
2001	\$ 18.31	\$ 24.83	136%	110.3	\$ 1,097.24	Appropriation Act transferred (\$5.8 billion)
2002	\$ 21.85	\$ 21.50	98%	132.3	\$ (67.11)	Budget Year prices adjusted
2003	\$ 18.14	\$ 27.26	150%	142.5	\$ 1,861.00	Appropriation Act transferred \$1.1 billion
2004	\$ 21.69	\$ 32.80	151%	134.0	\$ 2,286.85	Appropriation Act transferred \$1.6 billion
2005	\$ 23.92	\$ 45.86	192%	132.8	\$ 4,230.43	Appropriation Act transferred \$1.1 billion; 2 standard price adjustments
2006	\$ 40.45	\$ 66.02	163%	130.7	\$ 4,455.97	3 standard price adjustments
2007	\$ 61.44	\$ 64.62	105%	132.5	\$ 564.61	2 standard price adjustments
2008	\$ 67.61	\$ 107.67	159%	132.5	\$ 6,676.57	3 standard price adjustments
2009	\$ 84.01	\$ 57.23	68%	129.0	\$ (4,920.87)	5 standard price adjustments
2010	\$ 60.98	\$ 77.14	126%	130.5	\$ 2,807.21	3 standard price adjustments

-“Crude – OMB BUDGET PROJECTION” obtained from unpublished economic assumptions used in the President’s Budget

-“Crude - ACTUAL” calculated by fiscal year using monthly average crude prices reported by Energy Information Administration

-Refined product data obtained from DLA Energy

*Beginning FY06, standard price adjustments are used by DLA Energy to capture pricing disparities between budgeted and actual product costs. Supplemental funding is applicable to the Services.

Source: Defense Business Board. “Re-examining Best Practices for DoD Fuel Acquisition”, Report to the Secretary of Defense. FY11-06

Notes: As congressional appropriations have become less available as a means to correct the DCWF, OSD and OMB have turned to Standard Price revisions as a means to restore solvency to the fund.

HEDGING FOR DLA-ENERGY: CURRENT PRACTICES

The DLA-Energy arm does not currently utilize fuel price risk management in its procurement process. It possesses a limited, natural hedge through its use of the DCWF. This DoD-wide reserve fund offers an agency buffer against market volatility, **although growing fuel price volatility has hindered the fund's effectiveness.**

DLA-Energy solicits all bulk fuel contract bids via a single federal web repository. Contracts are assessed and awarded by computer program; they are resolicited on an annual basis. Awards are evaluated based on a Base Unit Price that reflects the difference between the award price and the index price (typically drawn from Platts). There is an adjustment mechanism built into contracts that will fluctuate with the market rates, usually either daily or weekly.

Although DLA-Energy pays suppliers based on spot market values, it uses the Standard Price for fuel sold to its Armed Services customers. The Standard Price is a budget mechanism used to shield the Armed Services from market volatility: it is set as much as eighteen months before implementation, in coordination between OMB and OSD and using information provided by DLA-Energy. The Standard Price, in theory, guarantees that the Armed Services will pay a single, set value for a fuel product over the FY.

Yet because the Standard Price is also the mechanism by which the DCWF maintains solvency – and because DoD is now less able to gain corrective appropriations from DoD – the Standard Price has been adjusted several times mid-year in recent fiscal cycles. This has created unneeded volatility in the Armed Services' budgeting. However, market hedging by DLA-Energy would have indirect, potentially negligible impact on stabilizing the Standard Price. The Standard Price is fundamentally a bureaucratic challenge, not a market engagement one.

Although this system is complex, BENS review has shown that DLA-Energy does not expend appreciably more for like fuel grades than comparable private sector companies.

HEDGING FOR DLA-ENERGY: PROS

The Defense Business Board (DBB) has recommended fuel price risk management as a vehicle toward net savings and reduced volatility.²¹ The DBB's principle arguments, supplemented by BENS observations:

- **Budget stability.** The DBB notes that hedged fuel prices will lead to greater certainty in DoD-wide planning and budgeting. *This is the strongest argument in favor of fuel price risk management.* However, while hedging would exert a positive departmental effect, it would have less impact on the individual Armed Services. This is because the Armed Services – in theory – are already shielded from market volatility by the Standard Price. The Standard Price mechanism distinguishes the United States military from that of other countries which lack a comparable budgeting tool.²²
- **Overall risk mitigation.** In normalized market circumstances, hedging decreases exposure to price volatility and thus risk.²³ This is another strong argument for adoption of hedging practice. However, unlike private industry (which can benefit from “long” multi-year hedging), the public sector is typically limited to fund availability within the fiscal year.
- **Public and private precedent.** Airlines, power utilities, energy exploration and production companies, and other sovereign states (including Britain, France, and Israel) all make use of hedging in their market engagement strategies. This is not an untested strategy; it has been successfully utilized in the public sector in other contexts.

HEDGING FOR DLA-ENERGY: CONS

The DBB has also identified associated risks and obstacles with DLA-Energy's adoption of hedging practices. Indeed, in a previous 2004 review of DLA-Energy buying practices, the DBB recommended **against** hedged procurement. These arguments are again supplemented by BENS observations:

- **Limited potential for ROI.** DLA-Energy's adoption of hedging will require substantial enhancement of market engagement and analysis capabilities. Alternately, it would require contracting with a third-party fuel price risk management professional to develop an initial plan. Both

will be costly. *Moreover*, optioned hedging (likely given DLA-Energy's governmental status) will invite additional premiums barring use of engagement mechanisms like costless collars. For hedging to be net financial positive, it would need to demonstrate a ROI in mitigated risk sufficient to justify these expenditures.

- **Chance of catastrophic negative return.** Should the price hedging not be optioned – or should the option not be exercised – the possibility exists for a substantial net loss in the event of an unanticipated downward market

revision. If DLA-Energy engaged in unprotected hedging, a repeat of the 2008 oil crash would have a catastrophic impact on both DoD and the individual Armed Services.

- **Political liability.** As DLA-Energy representatives have observed on several occasions, the agency will be considered liable for any miscalculation in the hedging process. If fuel price risk management was widely perceived to have led to a net increase in costs (and therefore taxpayer expenditure), DLA-Energy would face criticism from both Congress and the public at large.

CONCLUSION

A comprehensive overview of hedging in the private sector, public sector, and DLA-Energy contexts does not suggest the potential for widely realized savings in DoD fuel procurement operations. By definition, hedging is an uncertain enterprise; these uncertainties are amplified in the case of public sector entities. DLA-Energy's unique institutional context further dilutes and confuses hedging's end utility.

BENS would be willing to endorse a pilot program, as proposed by DBB, in which DLA-Energy hedged a small (5 to 10 percent) proportion of its JP8 fuel buy.²⁴ However, the price of an RFI for a risk management consultant would need to be pre-determined, as would the premium of an optioned hedge. These costs would be weighed against immediate market realities, based on available bids. Only then, with a positive on-the-spot assessment, might hedging provide appreciable savings for DLA-Energy.

BENS MENTORSHIP PROGRAM

The BENS Mentorship Program has its roots in the BENS Southeast Region. A pilot was successfully conducted in Atlanta in 2009 with ten mentor / coach pairs with BENS members coaching Army civilians at the former Southeast Regional headquarters of the Installation Management Command (IMCOM). Upon its success, the program expanded in 2010 to include IMCOM officers and civilians at Army installations in the Southeast and Southwest. The program was elevated to the Army's executive level in 2011 when Lieutenant General Rick Lynch, then Commander of IMCOM, asked for coaches for himself, his direct reports, and other key executives - 19 in total. It continues today with Lieutenant General Michael Ferriter, the current Commander, and his key officers and executives. Further expansion is expected to include additional Army Commands and other Military Services in areas where business experience is highly applicable.

WHAT IS AN EXECUTIVE MENTOR?

Executive mentoring is a developmental partnership through which one person shares knowledge, skills, information, and perspective to foster the personal and professional growth of someone else. Many successful organizations have realized great value in coaching programs to meet such challenges as preparing current and future leaders, retaining high performers, addressing diversity, managing collective knowledge and reduce the cost of learning.

BENEFITS OF COACHING

Research suggests that a successful coaching program is an important factor in:

- Driving retention through informal learning, which leads to an increase in personal satisfaction.
- Providing an opportunity for personal to gain knowledge from a more experienced senior level business partner.
- Advancing talented individuals by developing future leaders.
- Positively influencing protégés perceptions of career success and organizational commitment.
- Managing organizational knowledge.
- Helping to achieve diversity goals.

GUIDING PRINCIPLES

1. Voluntary participation
2. Mutually beneficial
3. Match needs with skills
4. Active participation by both the Military Leaders and Executive Mentors
5. One year participation commitment, which can be extended by mutual agreement

6. All Military Leader-Executive Mentor exchanges are confidential
7. Be respectful of each other's time and commitments
8. Candid, open and honest communication –should be a 'safe harbor' environment
9. Respect for different points of view

The Executive Mentor, will be mentoring and advising, and not directing the Military Leader. The mentor is there as a resource to provide advice, not to assign work.

Active participation by the Executive Mentor and the Military Leader is important; however, the Military Leader is responsible for driving the relationship. The Military Leader will initiate monthly meetings with the Executive Mentor, face-to-face if possible. If the Executive Mentor is not contacted, they should take the initiative and contact the Military Leader.

INITIAL MEETING

The initial meeting should take place within 30 days of the Executive Mentor / Military Leader pairing being established.

The Executive Mentor and the Military Leader should define their relationship together during the initial meeting. The Executive Mentor will lead the initial meeting by covering the following:

- Define relationship boundaries such as time limitations, discussion topics, reiterate the absolute confidentiality of any discussions that occur.
- Define goals for the Executive Coach / Military Leader relationship over the next twelve months.

- Discuss and clarify expectations about frequency of contact and Executive Coach /Military Leader roles.
- Identify and discuss coaching relationship timeline and expectations.
- Work with the Military Leader to establish career goals and objectives.

FOLLOW-ON MEETINGS

During the on-going meetings, Executive Mentor and the Military Leader both play a key role in the relationship. As a coach:

- Request a list of topics/issues from the Military Leader at least three business days prior to A meeting.
- Share best practices, ideas, experiences, knowledge, contacts and other information, such as templates/tools with the Military Leader.

All Executive Mentor / Military Leader exchanges are confidential and require significant trust to be effective. An Executive Mentor / Military Leader relationship shall last for the minimum duration of one year, but the Executive Mentor / Military Leader relationship can be extended beyond one year with mutual agreement.

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